

## Editor's note

Following the tri-annual edition of the *Croatian Economic Survey* for the period 1996 - 1999 issued in April 2002, here is a new tri-annual edition covering the period 2000 - 2002. Our intention is to catch up with the tradition of publishing annual editions of our journal as well as to bring the Croatian economic research which was conducted during the period involved to a broader international readership. We sincerely hope to be able to publish the *Croatian Economic Survey* annually from now on, as a periodical collection of selected research studies originally written in Croatian and published in the *Economic Trends and Economic Policy* journal (*Privredna kretanja i ekonomska politika*).

The period between 2000 and 2002, during which the articles published in this issue were written, was characterized by a relative macroeconomic stability and economic recovery. By the beginning of that period, most of the earlier weaknesses such as high inflation, substantial fiscal deficit and banking crises had been long overcome although there were still many problems lurking about to jeopardize economic stability and growth, namely high unemployment and the deficit in merchandise trade.

Those changing circumstances on the home front have shifted the focus of economic research from diagnosing the sources of the imbalance and the ways of their removal to the issue of maintaining the attained level of macroeconomic balance and stability. Many researchers have steered away from developing measure recommendations and policy-making guidelines, designing and implementing reform programs and economic-institution building towards monitoring the effects of economic policy measures and conducting positive analyses concerned with the functioning of institutions. Moreover, their success in tackling some major economic problems has left enough room for economic experts to address the issues beyond 'mainstream' economic concerns, such as innovation,

human resources, environmentalism, economic statistics improvement, e-business, etc.

This edition features six articles which deal with the current economic reality in Croatia and reflect quite accurately the switch in the economic policy priorities as well as in the focus of economic research. The articles presented in this issue cover a wide variety of topics, ranging from economic inequality, currency disturbances, assessment of the unofficial economy, capacity to finance the fiscal deficit, inflationary dynamics to the impact of currency substitution on an open country's monetary policy.

The first paper by Danijel Nestić, *"Economic Inequality in Croatia in 1998: Lower than Expected"* challenges a widespread belief as well as the World Bank's study on poverty and economic inequality in Croatia that income inequality in Croatia is significantly higher than generally observed in transition and market economies. Its results based on micro-data from the 1998 Household Budget Survey indicate no substantial departure from the average for other countries in transition. The paper also presents the results of the decomposition of inequality, which reveals that education and labor force participation are the most important factors behind disparities in income and consumption. On the other hand, gender or age of a household head, settlement and household types seem to predict inequality rather poorly.

Amina Ahec-Šonje and Ante Babić in their article *"Measuring and Predicting Currency Disturbances in Croatia: The Signals Approach"* examine the currency disturbances that took place in Croatia at the beginning of 1999 and in the summer of 2001. They use the "signals approach" to construct an effective system of early warning indicators heralding currency disturbances. The performance of the indicators reveals that the two disturbances were different: the one in 1999 came at the end of a banking crisis, while the 2001 disturbance was brought about by a combination of the domestic monetary relaxation and partial capital account liberalisation.

The next article *"Assessment of the Unofficial Economy in the Republic of Croatia in 1998 Using the System of National Accounts"* by Davor Mikulić was motivated by the fact that the complete economic indicators are a necessary prerequisite for good economic policymaking. Therefore, it is useful to possess an estimate of the extent of economic activities that bypass the standard statistical system of a country. In his article, Davor Mikulić applies the method of discrepancy in the system of national accounts to assess the scope of unofficial economy in the Republic of Croatia in 1998. The total unofficial economy based on this estimate is between 9.3

percent and 12.8 percent of the officially recorded GDP, but the author stresses that this result should be interpreted with caution, since the method applied usually generates the lower limit of the estimate.

The article *"Croatia's Capacity to Finance Its Fiscal Deficit"* by Sandra Švaljek represents an attempt to determine the level of fiscal deficit which is consistent with the expected and desirable levels of macroeconomic indicators, such as economic growth and the rate of inflation. At the same time it takes into account the existing foreign trade potentials of the country as well as characteristics of foreign demand for exports. Empirical analysis has shown that Croatia has rather limited possibilities to finance its fiscal deficit. Foreign debt financing is to a large extent limited by dynamics of exports, while the domestic debt financing is limited by a relatively low rate of growth of domestic economy. Financing through issuing money should be avoided because of possible inflationary effects.

James E. Payne in his paper *"Inflationary Dynamics of a Transition Economy: the Croatian Experience"* undertakes an analysis of the inflationary dynamics in Croatia over the period January 1992 - December 1999. Recognizing the structural break in the inflationary process corresponding to the anti-inflationary stabilisation programme of October 1993, the analysis proceeds by estimating an augmenting vector autoregressive model of the log first-differences for the broad money supply, retail price index, nominal net wage per employee, and the nominal effective exchange rate along with evaluating generalized forecast error variance decompositions to infer the empirical relationship among the four variables. The results show that inflation is positively related to wage growth and currency depreciation. Interestingly enough, lagged values of inflation are insignificant suggesting the absence of inflation inertia.

It should be apparent that the articles published in this issue appear in their chronological order, starting from the most recent one. Although the last article, written by Velimir Šonje and entitled *"The Openness of the Country, Currency Substitution and Monetary Policy"*, was least recently written it is nevertheless as relevant today as it was when first published. It discusses the impact of the openness of a country and currency substitution, both important features of the Croatian economic and monetary system, on monetary policy. The author claims that standard macroeconomic models tend to overlook the presence of currency substitution and, consequently, result in misguided monetary policy recommendations. He argues that the openness of a country and the size of currency substitution affect the ratio of international reserves to the reserve money and can seriously limit monetary policy since open countries with high currency

substitution will normally be more sensitive to international capital flows and foreign exchange fluctuations.

We believe we have provided a representative scope of the recently conducted economic research in Croatia and hope it would foster a lively debate within the national and international economic community as well as provide our fellow scientists with fresh ideas for their new research projects.

Guest editor:

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